ORIGINAL

BEFORE THE ARIZONA CORPORATION CC

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR APPROVAL OF A POWER SUPPLY ADJUSTOR SURCHARGE.

DOCKET NO. E-01345A-05-0526

STAFF'S RESPONSE TO COMMISSIONER MAYES' AUGUST 4, 2005 LETTER

This pleading will attempt to respond to the questions contained in Commissioner Mayes' August 4, 2005 letter. We have tried to provide direct responses to the questions contained therein and hope that these answers will be helpful to the Commission in evaluating these issues.

I. DECISION NO. 67744 DOES NOT PROHIBIT APS FROM REQUESTING AMORTIZATION OF ITS BANK BALANCE BEFORE THE APRIL RESET OF ITS ADJUSTOR RATE.

The relevant language of the Commission's order follows:

> [W]e will limit the adjustor to 4 mil from the base level over the entire term of the PSA and will cap the balancing account to an aggregate amount of $100 million. Should the Company seek to recover or refund a bank balance pursuant to Paragraph 19(e) of the Settlement Agreement, the timing and manner of recovery or refund of that existing bank balance will be addressed at such time. <u>In no event shall the Company allow the bank balance to reach $100 million prior to seeking recovery or refund.</u> Following a proceeding to recover or refund a bank balance between $50 million and $100 million, the bank balance shall be reset to zero unless otherwise ordered by the Commission.

(Decision No. 67744 at 17 (emphasis added)). This language requires the Company to either seek an amortization of its bank balance before that bank balance reaches $100 million or risk disallowance of any portion of the bank balance that exceeds $100 million. (Op. Mtg. Tr., Vol. II at 314-15).

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In light of this requirement, the question then focuses on the definition of the term "bank balance": does the "bank balance" only come into existence after the April reset of the adjustor rate or does it exist before that time? Since neither the Commission's order nor the Settlement Agreement offers a specific definition of the term "bank balance," it is necessary to consider the use of that term in the context of the proceeding as a whole.

It is reasonable to begin with an examination of the settlement agreement itself. Paragraph 19(d) provides that any spillover from the four mil bandwidth shall be recorded in a "balancing account" that shall "carry over to the subsequent year or years." Paragraph 19(e) states that APS must make a filing with the Commission once the balancing account reaches plus or minus $50 million. Focusing upon these two paragraphs in isolation, one could argue that the balancing account first comes into existence after the April reset referred to in Paragraph 19(b). However, it is more reasonable to consider these paragraphs in conjunction with Paragraph 20(a), which states that APS shall provide monthly reports to the Commission that track its "bank balance calculation." This paragraph refers to the bank balance as an ongoing concept, i.e., as the record of the ongoing deferrals of the difference between APS' prudently incurred costs of fuel and purchased power and APS' actual recovery of those costs through base rates (approximately 2.07 cents per kWh) plus the adjustor rate (currently set at zero).

One could argue that the term "balancing account" used in Paragraphs 19(d) and (e) is a distinct concept from the term "bank balance" used in Paragraph 20. The Commission's order, however, appears to use these terms interchangeably, drawing no distinction between the two in the language that creates both the $100 million cap and the requirement that APS file for recovery/refund before the bank balance reaches $100 million. (Decision No. 67744 at 17, lns. 9-16). Focusing on the language of the Commission's order and the terms of the settlement agreement, Staff concludes that the term "bank balance" was intended to refer to APS' ongoing cost deferrals.

This conclusion is supported by the Commission's open meeting proceedings. While addressing the amendment that proposed the $100 million cap, the discussion appears to focus upon preventing the accumulation of large bank balances:

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> Chm. Hatch-Miller: And the intent of the language is to?
>
> Mr. Kempley: The intent of the language is to clarify what I think we all believe is the purpose of your amendment, and that is to not disallow costs, <u>but to ensure that a proceeding to examine the bank balance takes place both after the bank balance reaches $50 million, but before it could reach 100 million</u>.

(Op. Mtg. Tr., Vol. II at 313 (emphasis added)). Other comments suggested that the proposed amendment would encourage the Company to "bring an escalating bank balance" to the Commission's attention "well before it reaches $100 million . . . ." <u>Id.</u> at 314. After hearing these comments, the Commission passed the amendment incorporating the proposed $100 million cap four to one. <u>Id.</u> at 321-22.

II. THE TESTIMONY AND THE DOCUMENTS IN THIS CASE SHOW THAT THE PARTIES RECOGNIZED THAT APS MIGHT SEEK TO AMORTIZE THE BANK BALANCE BEFORE THE APRIL RESET OF THE ADJUSTER RATE.

The letter identifies portions of the record containing Mr. Gray's and Mr. Johnson's separate testimony at the evidentiary hearing and Mr. Wheeler's and CALJ Farmer's separate comments at the Commission's open meeting. The letter suggests that these sources demonstrate the parties' intent for the surcharge to apply only after the April reset of the adjuster rate. Staff is unable to conclude that these persons' comments provide unambiguous support for the conclusion.

Mr. Wheeler's comments in this instance, for example, are unclear. Mr. Wheeler's specific statement follows:

> Because once we start off on this PSA, you know, <u>the first adjustment, if there is one—and remember you control that</u>—will barely put us up to where we were when we put these rates into effect.

(Op. Mtg. Tr., Vol. I at 40-41 (emphasis added)). It is unclear whether these comments refer to the adjustor rate, which pursuant to Paragraph 19(b) adjusts automatically unless suspended by the Commission, or to the surcharge, which pursuant to Paragraph 19(e) cannot be established without affirmative Commission action. Because Mr. Wheeler refers to an adjustment that the Commission would specifically approve, it is more likely that he is referring to the surcharge, which can only be established after affirmative Commission action. Accordingly, it is not clear that Mr. Wheeler's statements in this context indicate that he believed the April reset must occur before APS could request a surcharge.

Both Mr. Gray's and CALJ Farmer's statements describe a possible sequence of events pursuant to Paragraphs 19(b)-19(e) of the Settlement Agreement. Staff acknowledges that these statements describe the PSA in terms of this particular sequence of events, beginning with the April reset and then proceeding to the amortization of the balancing account through a surcharge. These sources appear to suggest that the parties expected this particular sequence of events to take place over the coming year. For example, Staff witness Gray identified his Scenario 11 as the most likely. In that scenario, the balancing account would not hit $50 million before the April reset

Under the provisions of the settlement agreement, however, it would have been possible for the April reset to precede a surcharge application, even if the bank balance had reached $50 million or more before the April reset. This is because the settlement agreement did not require APS to seek a surcharge at any particular time and, more importantly, did not impose a cap on the balancing account. Under the settlement agreement, whatever sequence ultimately applied would affect only the timing of the recovery of prudently incurred costs, not the ultimate recovery of those costs.[1]

Furthermore, that the parties described and anticipated a particular sequence of events does not mean that the terms of the settlement agreement expressly foreclosed other possible sequences. Indeed, the possibility of other sequences was specifically mentioned at the evidentiary hearing. Mr. Wheeler, while describing the operation of the PSA, made the following statements:

> [Y]ou actually use a base number. The number was derived from 2002 with some adjustments to it, but you start with a base number that is specified in the settlement. It's 2.07 cents. The number is in the settlement. And you use that as the base against which to compare a similar amount computed for fuel and purchased power costs in subsequent periods.
>
> Then with that difference, either plus or minus after dealing with the 90/10 split, requires an adjustment. And assuming it doesn't exceed four mils, then you make the adjustment the following year, and if it exceeds the four mil threshold or bandwidth, then the balance above the four mils is put in the bank balance and recovered later. <u>And there's also a trigger point of $50 million, so if things get out of hand one way or another there's the opportunity for that to be addressed on something less than an annual basis</u>.

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[1] Pursuant to Paragraph 19(e) of the settlement agreement, APS was required to make a filing with the Commission once the balancing account reached $50 million. In that filing, APS could either ask for a surcharge/credit to amortize the under-recovered/over-recovered balance, or it could simply file a report explaining why it would be reasonable to forego amortization of the balance at that time. Although this provision as drafted required APS to notify the Commission when the bank balance reached $50 million, it did not require APS to seek recovery/refund at that time. And since the settlement agreement did not provide for a cap on the balancing account, APS was not at risk of failing to recover prudently incurred costs if it waited until after the April reset to recover any under-collected balance.

> Q. (By Com. Mundell): I want to understand the adjuster rates will be as you just described. Then once a year on April 1st you guys are going to look at it and it's going to be adjusted up or down?
>
> . By Mr. Wheeler: Yes, Commissioner. We will be making a filing that will allow you to determine the appropriate adjustment. The first adjustment wouldn't be made until April, '06.
>
> Q. That was my next question. The first adjustment would be April, '06?
>
> A. By Mr. Wheeler: <u>Unless the $50 million trigger was exceeded, in which case we could make a filing and you could determine whether to make an interim adjustment, assuming it isn't reached, then it would be '06 for the first adjustment</u>.

(Tr., Vol. I at 160-62 (emphasis added)).

Mr. Johnson's testimony echoes this theme:

> Certainly, there is a provision in the PSA component of [the] settlement agreement which identifies a what-if scenario. And under that what-if scenario, there is an opportunity for dollars in the range of $50 million that those dollars will have to be addressed. Let me tell you why I think that's important.
>
> You have had gas cases where, and this Commission, prior members of this Commission issued orders. What you have said is companies, when you reach a certain level of unrecovered costs, you need to come in. And the reason you come in is because as we're growing liability, right, owed by ratepayers, and at some point that balloon payment is going to come due, and <u>is it more responsible to mitigate or to deal with that balloon payment in increments that are more manageable as opposed to wait until it is not manageable</u>. So we think that this provision addresses that issue.

(Tr., Vol. II at 383-84 (emphasis added)). Both Mr. Johnson's and Mr. Wheeler's comments recognize that the settlement agreement allowed for the bank balance to be adjusted more frequently than once a year, if more frequent adjustments were necessary. This option was intended to serve as a sort of "safety valve" to allow the Commission a ready means to address an escalating bank balance, either positive or negative. (See Tr., Vol. II at 388, 391, 392-93). If the Commission were to determine that the public interest requires more frequent adjustments to the bank balance, implementing the surcharge before resetting the adjustor rate is not an illogical result.

To summarize, certain portions of the evidentiary record discuss the PSA in terms of an expected sequence of events, beginning with the April reset and then proceeding to the amortization of the balancing account. The parties appear to have expected this particular sequence of events to unfold over the 2005-06 timeframe. Other portions of the record, however, acknowledge the possibility that APS might file a surcharge application in advance of the April reset if its balancing account were to reach the $50 million trigger. The terms of the settlement agreement allowed both sequences.

So far, this pleading has discussed what the record may indicate about the parties' respective beliefs. While Staff has tried to respond directly to the questions posed, we acknowledge that determining the parties' various beliefs is not nearly as important as determining the Commission's intent as expressed in its final order. The Commission's intent will ultimately control the determination of these issues.

III. UNDER THESE CIRCUMSTANCES, APS' FILING IS UNLIKELY TO BE PREMATURE IF ITS BANK BALANCE IS APPROACHING $100 MILLION.

Nonetheless, it is important to acknowledge the difference between filing a premature application and asking for premature relief. Assuming for purposes of argument that APS' filing was not premature, there remains the question as to whether circumstances merit the imposition of a surcharge at this time. APS has asked the Commission to impose a $0.00177 per kWh surcharge beginning in November, 2005, fewer than seven months after the close of its recent rate case. APS has asked to amortize the existing bank balance beginning in November, even though it knows that its under-recovered bank balance is likely to decrease over the winter months and that the four-mil band width applicable to the April reset of the adjustor rate will recover approximately $100 million. Under these circumstances, it may be premature to grant APS the relief that it seeks. Staff looks forward to analyzing these issues in the upcoming proceeding and developing appropriate recommendations.

IV. THE COMMISSION'S ORDER DOES NOT LIMIT THE OPPORTUNITY FOR A SURCHARGE TO A ONE-TIME EVENT.

The Commission's order provides the following discussion of the potential surcharge:

> [W]e will limit the adjustor to 4 mil from the base level over the entire term of the PSA and will cap the balancing account to an aggregate amount of $100 million. Should the Company seek to recover or refund a bank balance pursuant to Paragraph 19(e) of the Settlement Agreement, the timing and manner of recovery or refund of that existing bank balance will be addressed at such time. In no event shall the

> Company allow the bank balance to reach $100 million prior to seeking recovery or refund. Following a proceeding to recover or refund a bank balance between $50 million and $100 million, the bank balance shall be reset to zero unless otherwise ordered by the Commission.

(Decision No. 67744 at 17). This language does not appear to limit the opportunity for a surcharge to a one-time event. Furthermore, Paragraph 19(d) of the settlement agreement did not contemplate the surcharge as a one-time event. (See Decision No. 67744, Attachment A at 4, para. 19(d) ("Any additional recoverable or refundable amounts shall be recorded in a balancing account and shall carry over to the subsequent year or years." (emphasis added)). The Commission's final order does not appear to have altered this concept.

The letter points to the portion of the Commission's order that states that "the bank balance shall be reset to zero . . . ." (See Decision No. 67744 at 17). The letter appears to suggest that the Commission, after a proceeding to amortize the bank balance, would reset the bank balance to zero on a permanent basis. In the context of the order and the settlement agreement, the term "bank balance" was intended to refer to the ongoing deferrals that make up the difference between APS' prudently incurred costs of fuel and purchased power and APS' actual recovery of these costs through base rates (approximately 2.07 cents per kWh) plus the adjustor rate (currently set at zero). (See Decision No. 67744, Attachment A at 5, para. 20). Permanently resetting the bank balance to zero would appear to preclude the Company from recording any further deferrals of either under-recovered or over-recovered prudent fuel and purchased power costs. By eliminating the Company's ability to record ongoing deferrals, the entire PSA would essentially be eliminated. This interpretation appears to be at odds with the language of the Commission's order, which does not appear to contemplate this result.

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V. CONCLUSION

Staff hopes that this document has answered the questions posed by Commissioner Mayes' letter. We look forward to addressing these issues further in the upcoming proceedings.

RESPECTFULLY SUBMITTED this 12th day of September , 2005.

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